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No. 84-303

IN THE SUPREME COURT
OF THE UNITED STATES

OCTOBER TERM, 1984

S. WILLIAM GREEN, EVELYN GREEN and CYNTHIA COLIN, as Executors of the Estate of Louis A. Green, deceased and EVELYN GREEN, individually, and as stockholders of Kirby Lumber Corporation, suing on behalf of themselves and for the benefit of said corporation and for the benefit of said corporation and for the class of all other stockholders of said corporation similarly situated,

Petitioners,

v.

SANTA FE INDUSTRIES, INC., SANTA FE NATURAL RESOURCES, INC., KIRBY LUMBER CORPORATION.

Respondents.

REPLY BRIEF IN SUPPORT OF PLAINTIFFS' PETITION FOR CERTIORARI

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S. WILLIAM GREEN, et al.,
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SANTA FE INDUSTRIES, INC., et al.,
Respondents.

REPLY BRIEF IN SUPPORT OF PLAINTIFFS' PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

1. THE PETITION SEEKS TO CORRECT BLATANT VIOLATIONS OF THE ERIE DOCTRINE

The petition raises "special and important reasons" for review, involving a gross misapplication of Erie v. Tompkins in two instances.

(a). As to the Martin Act, defendants concede that a New York State Court would apply New York case law. Thus the District Court sitting in New York, finding it "un-

necessary to address" New York case law, blatantly violated Erie in dismissing plaintiffs' Martin Act claim on the sole "basis" of Weinberger, a Delaware decision.* Since the District Court's violation of Erie is so clear, defendants simply ignore and thus, concede this point.**

(b). As to the breach of fiduciary obligation claim,*** the Federal District Court engrafted a limitation onto the explicit grandfather clause set forth in Weinberger, thus nullifying the state created remedy specifically preserved for these plaintiffs.

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* It is undisputed that the Martin Act is properly invoked because of the substantial acts which occurred in New York. This is not a conflicts-of-law question.

** Reference to the District Court includes the summary affirmance of the Court of Appeals for the Second Circuit.

*** It is undisputed that Delaware law governs this breach of fiduciary obligation claim.

Such abuse of power is in direct conflict with the command of Erie as expressed by this Court in Day & Zimmerman, Inc. v. Challoner, 423 U.S. 3, 4 (1975):

> "A federal court in a diversity case is not free to engraft onto... state rules exceptions or modifications which may commend themselves to the federal court, but which have not commended themselves to the state...."*

Contra defendants (7), plaintiffs first question presents an Erie issue. A federal court cannot escape the command of Erie by purporting to apply state law, yet create its own exception to the unequivocal holding of the recent decision by the states highest court, directly on point. That is not a matter of interpretation. A federal court's mere claim that it is interpreting state law cannot shield it from an improper abuse of power in failing to apply the law "as it finds it." Harris v. Atchison T. & S.F. Ry

* Emphasis supplied throughout unless otherwise noted.

Co., 538 F.2d 682, 690 (5th Cir. 1976). It is plain that the Federal District Court did not have the power to "second guess the highest court" of Delaware nor "inject itself into the development of state substantive law." Powell v. Charles Offutt Co., 576 F. Supp. 272, 278 (E.D.Tex. 1983), aff'd, 731 F.2d 886 (5th Cir. 1984) (citing Erie).

Contra defendants, the above Erie issues have far-reaching effects. Erie "goes to the heart of the relations between the federal government and the states." Wright, Federal Courts, 3d ed. (1976) p. 255. This petition, seeking to correct the federal abuse of power in disregarding states' rights, has significance for all federal courts.

(c). Defendants misrepresent the facts (5) by asserting that plaintiffs "were in the virtually unique position of still litigating a pre-1977 merger at the time the

Weinberger decision was announced." Defendants fail to mention that shareholders other than plaintiffs, who held 2,403 shares of Kirby, have two separate actions pending involving this 1974 merger: one in the Southern District of New York and another in the Supreme Court, New York County.*

2. CONTRA DEFENDANTS, THE LOWER COURTS NULLIFIED DELAWARE'S REMEDY EXPLICITLY "PRESERVED" FOR PLAINTIFFS IN CONTRAVENTION OF ERIE V. TOMPKINS

Defendants misrepresent the holding in Weinberger, stating (5):

> "The opinion in Weinberger clearly indicated that the rule there announced is not retroactive as to

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* Loengard et al. v. Santa Fe et al., 82 Civ. 7919 (KTD). The case in New York State Supreme Court involves the Borg plaintiffs in addition to the petitioners, herein, contra defendants (5).

> persons who, like the plaintiff in that case, had relied on the Singer decision in deciding to forego appraisal."

There is absolutely nothing said or indicated in Weinberger that the grandfather clause applied only to persons "who had relied on the Singer decision." Rather, Weinberger unequivocally stated (457 A.2d 714) that the "right to challenge the element of fair value must be preserved" in:

> "(4) any case challenging a cash-out merger, the effective date of which is on or before February 1, 1983."

Notwithstanding the explicit language above, the District Court transformed category (4) by inserting the following underlined words:

> "any case instituted after the decision in Singer v. Magnavox, 380 A.2d 969 (Del. Supr. 1977) challenging a cash-out merger, the effective date of which is on or before February 1, 1983."

That significant qualification by the District Court is not simply "interpretation", contra

defendants (8-9). By nullifying the Delaware remedy for all persons who instituted such suits before Singer, the lower courts invented a "policy consideration" and revoked Delaware's explicit policy. The proper function of a federal court in a diversity case "is to ascertain what the state law is, not what it [thinks it] ought to be." Klaxon Co. v. Stenton Elec. Mfg. Co., 313 U.S. 487, 497 (1941).

To demonstrate the District Court's blind spot, it stated "plaintiffs would reap a windfall that the Delaware Supreme Court could not have intended." (A 13). Weinberger clearly provides a remedy here since the fiduciary fleeced its cestui stockholders in a self deal by paying them $150 per share where the established asset value is $456

per Kirby share.*

In addition to the quasi-appraisal remedy "preserved" under the grandfather clause, Weinberger also explicitly stated that the Chancellor may fashion "any form of equitable and monetary relief" (457 A.2d at 714) where:

> "[t]he appraisal remedy we approve may not be adequate...particularly where fraud,...self-dealing,...or gross and palpable overreaching are involved."

Thus, under Weinberger, appraisal is not the exclusive remedy in a cash-out merger; contra defendants (4-5) and the District Court (All-12).

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* Weinberger citing Sterling v. Mayflower Hotel Corp., Del. Supr., 93 A.2d 107, 110 (1952) held: "The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts." Thus Weinberger confirms the fact that the 1952 rule of Mayflower is still the law in Delaware and has been at least since 1952.

The District Court abrogated Delaware's remedy for "fraud" and "gross and palpable overreaching." It has effectively converted a "fraud" against plaintiffs into a "windfall" for defendants, not plaintiffs. That unconscionable result is clearly not the command of Weinberger and no federal court has the power to change Delaware law.

Defendants flatly ignore pages 19-20 of plaintiffs petition; thus they have abandoned the District Court's "first" ground for refusing to apply the explicit grandfather clause, namely that plaintiffs "did not abjure an appraisal" within the language of Weinberger (A16). It is unrefuted that the District Court's conclusion is directly contrary to this Court's determination that "respondents [petitioners herein] . . . did not pursue their appraisal remedy in the Delaware Court of Chancery." 430 U.S. at 466-

467. Not pursuing an appraisal remedy is plainly equivalent to an abjural of appraisal.

3. DEFENDANTS CONCEDE THAT THE FEDERAL COURTS BELOW APPLIED THE LAW OF THE WRONG STATE, NAMELY DELAWARE, TO A CLAIM OF FRAUD UNDER NEW YORK'S MARTIN ACT, CONTRARY TO ERIE

Defendants abandon, as they must, the District Court's reason for dismissing plaintiffs' Martin Act claim, namely that it was based solely on the Delaware decision in Weinberger.*

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* The District Court simply stated (A6-A7): "Defendants now move for summary judgment on both causes of action on the basis of the recent holding in Weinberger v. UOP, Inc. Defendants argue that Weinberger is binding on all cases sub judice and, therefore, acts as a bar to the plaintiffs' action. For the following reasons, summary judgment is granted in the defendants' favor. Accordingly, it is unnecessary to address the arguments asserted under the Martin Act."

In fact, defendants agree with plaintiffs that the claim under New York's Martin Act is governed only "by the applicable New York authorities" (9), without reference to Delaware case law. Defendants, simply ignoring the Erie issue in plaintiffs' second question, concede that the answer should be in the affirmative.

Plaintiffs' claim under New York's Martin Act is for fraud. Contra defendants, the forced purchase of Kirby's minority shares, without prior notice of the merger, at a price of $150 per share where the undisputed asset value is $456 per share, constitutes a fraud.

Section 352-c 1(a) of the Martin Act explicitly prohibits "any fraud" (A21). The Court in Halle & Stieglitz v. Kolen* stated:

* Blue Sky L. Rep. (CCH) Para. 71,435 (N.Y. Sup. Ct. 1978) aff'd 71 A.D.2d 544, 418 N.Y.S.2d 552 (1st Dept. 1979).

> "The private right of action under General Business Law § 352-c is essentially a fraud action."

Shivers v. Amerco, 670 F.2d 826, at 831-832 (9th Cir. 1982) held:

> "New York's blue sky law does not parallel Rule 10b-5. N.Y. Gen. Bus. Law § 352-c prohibits fraud or misrepresentation...."

See also Bishop v. Commodity Exchange Inc., 564 F.Supp. 1557, 1565 (S.D.N.Y. 1983).

Unlike § 10(b) of the Securities Exchange Act of 1934, § 352-c of the Martin Act expressly prohibits "fraud", and is not confined to "deception" or "manipulation".

This Court in 1977 held that the Kirby freeze-out at an unconscionable price was not actionable under § 10(b) because it did not involve "deception" or "manipulation". Since "fraud" is expressly included in § 352-c, plaintiffs clearly state a Martin Act claim.

Defendants trifle with this Court in stating (9): "deception and reliance . . . are essential elements of any private damage action under the Martin Act." In People v. Barysh 95 Misc.2d 616, 620, 408 N.Y.S.2d 190, 193 (Sup. N.Y.Cty 1978), the Court stated that the Martin Act "clearly does not require several of the common law elements of fraud, namely, reliance and scienter". It is plain that in a forced sale situation, where the wrongdoers preempt plaintiffs from acting, reliance is "unnecessary". Vine v. Beneficial Finance Co., 374 F.2d 627, 635 (2d Cir. 1965).

Defendants (9-10) attempt to convert plaintiffs' "fraud" claim into one of "deception". In so doing, defendants distort the New York authorities. Shivers, supra, cited Halle & Stieglitz, supra, for the "'fraud or deception' requirement".

People v. Concord Fabrics, Inc., 83 Misc.2d 120, 371 N.Y.S.2d 550 (Sup. Ct. N.Y.Co), aff'd on opinion below, 50 A.D.2d 787 (1st Dept. 1975), involved a proposed freeze-out merger, on notice to the shareholders, with full disclosure, at an unconscionable price. It was enjoined under the Martin Act. On the facts, our case is a fortiori.*

4. PLAINTIFFS' ISSUES WERE BOTH RAISED BEFORE AND CONSIDERED BY THE COURT OF APPEALS, CONTRA DEFENDANTS (6-7)

The proper legal standard is that the issue be either raised or considered by the Court of Appeals before this Court will con-

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* Although the Court in Halle & Stieglitz, distinguished Concord Fabrics, the fact is that Halle & Stieglitz did not involve a freeze out merger transaction; there, plaintiffs accepted a tender offer which they later claimed had unfair terms and was coercive.

it. Adickes v. S.H. Kress & Co., 398 U.S. 144, 147 n.2 (1970). Plaintiffs satisfy this standard.

Defendants fail to point out that they themselves contended in the Court of Appeals:*

> "The District Court correctly applied Erie v. Tompkins in ascertaining how the Delaware Supreme Court would have decided the summary judgment motion."

Accordingly, the Court of Appeals had the Erie question before it.** Plaintiffs' two arguments below were the District Court's (i) creation of an exception to the unambiguous grandfather clause set forth in Weinberger; thus destroying the state remedy explicitly preserved for plaintiffs and

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* Heading of Point I of Defendants' Answering Brief, p. 15, dated March 2, 1984.

** Moreover, the District Court's decision specifically referred to "Erie v. Tompkins, 304 U.S. 64 (1938)" (A8).

(ii) erroneous application of Weinberger, a Delaware decision, to New York's Martin Act. The ground for both arguments was Erie. Defendants obviously considered that to be the issue inasmuch as they defended on that ground in the first point of their argument.

Defendants erroneously assert (6) that plaintiffs "did not argue, or even remotely suggest, that the District Court had refused to follow state law . . ." (original emphasis). In fact, the very first sentence of plaintiffs' "Point I", (p. 14) in their main brief in the Court of Appeals (dated February 10, 1984), asserted that the District Court had failed to follow state law:

> We submit that analysis of Weinberger demonstrates that the District Court misunderstood and failed to follow its holdings applicable to our case, thereby committing reversible error or law."

Moreover, with respect to New York's Martin

Act, plaintiffs argued in their main brief (p. 22) in the Court of Appeals:

> "The Court simply stated that 'it is unnecessary to address the arguments asserted under the Martin Act,' (388a) apparently because it erroneously believed that Weinberger, a Delaware decision, barred claims under New York's Martin Act. That is clear error of law."

That is precisely the same issue plaintiffs raise in their second question in this Court.

Accordingly, defendants' arguments that the issues herein were never raised below are without merit.

5. DEFENDANTS' CLAIM FOR DAMAGES UNDER RULE 49.2 IS SHAM

The petition and this brief demonstrate that the petition should be granted. Even if it is not granted, it clearly is not frivolous, where defendants fail to refute the fact that the District Court applied the law of the wrong state to plaintiffs' Martin

Act claim. Moreover, the District Court's nullification of plaintiffs' state-created remedy explicitly granted to them under Delaware law, is a plain violation of Erie v. Tompkins. Thus, this case is clearly not one of those highly unusual instances where it can be said that plaintiffs are guilty of bad faith. Accordingly, defendants' claim under Rule 49.2 should be denied.

CONCLUSION

For the reasons stated in the Petition and in this brief, The Petition for Writ of Certiorari should be granted.

Dated: October 9, 1984

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